

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

LIBERTY MUTUAL INSURANCE)	
COMPANY AND SUBSIDIARIES,)	
)	
Plaintiff,)	
)	
v.)	Cnsl. Cv. No. 1:05-cv-11048-RCL
)	
UNITED STATES OF AMERICA,)	
)	
Defendant.)	

LIBERTY MUTUAL FIRE INSURANCE)	
COMPANY AND SUBSIDIARIES,)	
)	
Plaintiff,)	
)	
v.)	Former Cv. No. 1:05-cv-11049-RCL
)	
UNITED STATES OF AMERICA,)	
)	
Defendant.)	

DECLARATION OF JAMES W. KRESS

I, James W. Kress, hereby declare as follows:

1. I have been employed in the Corporate Taxation Department of Liberty Mutual Insurance Company since 2003. My duties have included tax compliance issues, work on IRS audits, and assisting with financial statements. My current position is Senior Tax Manager.
2. I have reviewed the tax files and Annual Statement records of Liberty Companies.

3. On or before September 15, 1991, Liberty Mutual filed a consolidated federal income tax return for the taxable year ended December 31, 1990, reporting a fully paid tax liability of \$46,400,348. A copy of the cover page of this return are included as Attachment Kress-1 to this Declaration.

4. The following property and casualty insurance companies, among other companies, were included as members in Liberty Mutual's taxable year 1990 consolidated return: Liberty Mutual; Liberty Insurance Corporation; and Liberty Northwest Insurance Corporation.

5. On or before September 15, 1991, Liberty Fire filed a consolidated federal income tax return for the taxable year ended December 31, 1990, reporting a paid tax liability of \$3,787,359. A copy of the cover page of this return are included as Attachment Kress-2 to this Declaration.

6. Liberty Mutual, Liberty Insurance Corporation and Liberty Fire were subject to a reinsurance pooling agreement under which their premiums and losses incurred, including such components as salvage and subrogation, were accounted on a pooling percentage basis. During the relevant years, the respective percentages under the pooling agreement were as follows:

Liberty Mutual	84%
Liberty Fire	10%
Liberty Insurance Corporation	6%

7. The Internal Revenue Service ("IRS") conducted an extensive examination of Liberty Mutual's and Liberty Fire's consolidated tax returns for the taxable year 1990 and proposed adjustments to premiums, losses incurred and other items to be distributed between the two returns according to the companies's pooling percentages.

8. At the conclusion of the examination, the IRS issued separate thirty-day letters with an accompanying Revenue Agent's Report in which it proposed adjustments to taxable income based on a number of issues.

9. On June 15, 1995, Liberty Companies protested the thirty-day letters and accompanying Revenue Agent's Reports to the Appeals Office of the IRS.

10. All issues for Liberty Mutual were settled except the issues reserved on the Form 870-AD executed at the close of the appeal. A copy of the first page of the Form 870-AD for Liberty Mutual is attached to this Declaration as Attachment Kress-3.

11. All issues for Liberty Fire were settled except the issues reserved on the Form 870-AD executed at the close of the appeal. A copy of the first page of the Form 870-AD for Liberty Fire is attached to this Declaration as Attachment Kress-4.

12. On their originally-filed tax returns for the taxable year 1990, Liberty Companies changed their methods of accounting to reflect discounted estimated salvage recoverable on all lines as required by the 1990 Act.

13. The Liberty Companies applied the transition rules of the 1990 Act with respect to December 31, 1989 discounted estimated salvage recoverable.

14. For Gross Lines on which Liberty Companies had not taken any estimated salvage into account on the 1989 Annual Statements, they included in income \$2,234,800 as the partial 26 U.S.C. § 481 adjustment. This amount is equal to one-quarter of 13 percent of \$68,763,074, the discounted estimated salvage on Gross Lines.

15. For Net Lines on which Liberty Companies had taken estimated salvage into account on the 1989 returns as a reduction of losses incurred, Liberty Companies claimed a Special Deduction on their originally-filed 1990 returns pursuant to section 11305(c)(3) of the 1990 Act in the amount of \$41,583,257. This amount is equal to one-quarter of 87 percent of \$191,187,388 of discounted estimated salvage recoverable on Net Lines.

16. On audit, the IRS subsequently changed this amount and the change was agreed to by Liberty Companies.

17. At the September 15, 1991, extended due date for the Liberty Companies' 1990 tax returns, insurance industry discussions with the IRS and Treasury concerning the double-counting problem and the IRS's position that the Special Deduction was an exclusive transition rule were still underway, and many expected future guidance from the IRS to result.

18. Accordingly, Liberty Companies included a statement with their 1990 tax returns stating that they could not then determine the full amount of estimated salvage recoverable and that they disagreed with the position of Rev. Proc. 91-48 that the 1990 Act could be ignored. Because future IRS guidance was expected, Liberty Companies specifically reserved the right to change the position taken on the tax returns, stating "Further clarification resulting from industry discussion with the Internal Revenue Service on these items may result in the taxpayer filing an amended return." A copy of this statement for Liberty Fire is attached to this Declaration as Attachment Kress-5.

19. On or before September 15, 1992, Liberty Companies filed their tax returns for tax year 1991.

20. In September 1993, during the course of the examination of their 1990 income tax returns, Liberty Companies filed with the IRS a request to convert its Net Lines into Gross Lines, effective for tax year 1990 as permitted by the regulations. A copy of the affirmative adjustment for Liberty Fire is attached to this Declaration as Attachment Kress-6.

21. In the request for affirmative adjustment Liberty Companies specifically stated that it did not claim the Special Deduction because, for tax purposes, they no longer had any Net Lines. In the request, Liberty Companies' asked that loss reserves be grossed up for estimated salvage recoverable on Net Lines. Under the terms of Rev. Proc. 92-77 as it applied to the change required by the 1990 Act, the grossed-up estimated salvage recoverable was subject to the Fresh Start applied to salvage as of December 31, 1989.

22. The affirmative adjustment also claimed revised amounts of discounted estimated salvage recoverable on Net Lines, corrected (consistent with the disclosure on the 1991 Annual Statement) to reflect information that was not available at the time the original returns for 1990 were filed. As corrected, the relevant year-end 1989 and 1990 discounted estimated salvage recoverable amounts of Liberty Companies' were as follows:

DISCOUNTED SALVAGE	<u>12/31/89</u>		<u>12/31/90</u>
	Net Lines	Gross Lines	Net Lines
Liberty Mutual Ins. Co.	180,819,158	61,886,767	190,901,955
Liberty Mutual Fire Ins. Co.	19,650,028	6,876,307	20,767,361
Liberty Companies total	200,469,186	68,763,074	211,669,316

23. The IRS examined the 1990 returns and affirmative adjustments of Liberty Companies. As a result of the audit, the IRS agrees to the amounts of discounted estimated salvage, including the corrected amounts of December 31, 1989 discounted estimated salvage on Net Lines.

24. The following amounts of salvage at December 31, 1989 are those agreed with the IRS agent:

12/31/89 SALVAGE	<u>Undiscounted</u>		<u>Discounted</u>	
	Net Lines	Gross Lines	Net Lines	Gross Lines
Liberty Mutual Ins. Co.	231,389,202	65,179,800	180,819,158	61,886,767
Liberty Mutual Fire Ins. Co.	25,126,347	7,242,200	19,650,028	6,876,307
Liberty Companies total	256,515,549	72,422,000	200,469,186	68,763,074

25. The IRS made an audit adjustment with respect to the transition treatment of December 31, 1989 discounted estimated salvage on Gross Lines which Liberty Companies had not taken into account before tax year 1990. The IRS adjusted Liberty Companies' income to require them to include in income the full amount of that salvage as a 26 U.S.C. § 481 adjustment in 1990, without permitting either the 87 percent exclusion or the four-year spread under the of the Fresh Start transition rule in section 11305(c)(2) of the 1990 Act.

26. Further, the IRS audit did not allow the gross-up of loss reserves under Rev. Proc. 92-77 and the regulations for discounted estimated salvage recoverable on Net Lines, as requested in the affirmative adjustment.

27. Instead, for the Net Lines, the IRS allowed a Special Deduction equal to 87 percent of the December 31, 1989 corrected discounted estimated salvage recoverable balance, spread ratably over four years beginning in 1990.

28. Because it was based on the corrected amount, the IRS audit allowed a Special Deduction for tax year 1990 that was \$2,882,028 more than the amount claimed on Liberty Companies' original 1990 tax returns.

29. These audit adjustments resulted in an increase in tax for 1990, which Liberty Companies paid in full.

30. Liberty Companies neither made, nor sought to make, any change in method to "remove estimated salvage recoverable" with respect to any accident year from unpaid losses. Liberty Companies made no change of accounting with respect to salvage in 1990 except to report estimated salvage on Gross Lines as required by the 1990 Act. Beginning in 1990 and consistently in all later years, in filing their original tax returns, amended returns, requests for adjustment and refund claims, Liberty Companies have never deviated from reporting losses incurred which reflected estimated salvage on both Net and Gross Lines.

31. On page 60 of the Revenue Agent's Report dated March 15, 1995, the Internal Revenue Service explained its basis for denying Liberty Companies a gross-up of their estimated salvage under Rev. Proc. 92-77 for the taxable year 1990, as follows:

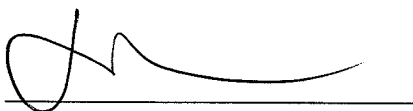
"The government contends, pursuant to Treas. Reg. 1.832-4(f)(3)(iii), that any taxpayer that 'claims the special deduction is precluded from also claiming the section 481 adjustment . . .' The government also maintains that once a company has taken the special deduction any change in method of computing unpaid

losses can only be done so with the consent of the Commissioner.
This position is based on section 4.04 of Rev. Proc. 92-77.”

A copy of this page of the Revenue Agent’s Report is attached to this Declaration as Attachment
Kress-7.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed on September 28, 2006.

A handwritten signature in black ink, consisting of a stylized 'J' followed by a series of loops and a long horizontal stroke, positioned above a solid horizontal line.

James W. Kress

04-1543470

Form 1120		U.S. Corporation Income Tax Return		OMB No. 1545-0123	
Department of the Treasury Internal Revenue Service		For calendar year 1990 or tax year beginning ending		1990	
Check if a - A Consolidated return B Personal holding co. C Personal service corp. (as defined in sec. 1441-41 - see instructions)		Name LIBERTY MUTUAL INSURANCE COMPANY CORPORATE TAXATION Number, street, and room or suite no. (If a P.O. box, see page 2 of instructions) 175 BERKELEY STREET POST OFFICE BOX 140 City or town, state, and ZIP code BOSTON, MASSACHUSETTS 02117-0140		Employer identification number 04-1543470 Date incorporated Total assets (see specific instructions)	
D Check applicable boxes: (1) Initial return (2) Final return (3) Change in address					
1 Gross receipts or sales		b Less returns and allowances		c Bal	
2 Cost of goods sold (Schedule A, line 7)				2	
3 Gross profit (line 1c less line 2)				3	
4 Dividends (Schedule C, line 19)				4	
5 Interest				5	
6 Gross rents				6	
7 Gross royalties				7	
8 Capital gain net income (attach Schedule D (Form 1120))				8	
9 Net gain or (loss) from Form 4797, Part II, line 18 (attach Form 4797)				9	
10 Other income (see Instructions - attach schedule)				10	
11 Total income - Add lines 3 through 10				11	
12 Compensation of officers (Schedule E, line 4)				12	
13 a Salaries and wages		b Less jobs credit		c Balance	
14 Repairs				14	
15 Bad debts				15	
16 Rents				16	
17 Taxes				17	
18 Interest				18	
19 Contributions (see Instructions for 10% limitation)				19	
20 Depreciation (attach Form 4562)		20		20	
21 Less depreciation claimed on Schedule A and elsewhere on return		21a		21b	
22 Depletion				22	
23 Advertising				23	
24 Pension, profit-sharing, etc., plans				24	
25 Employee benefit programs				25	
26 Other deductions (attach schedule)				26	
27 Total deductions - Add lines 12 through 26				27	
28 Taxable income before net operating loss deduction and special deductions (line 11 less line 27)				28 259,742,636	
29 Less: a Net operating loss deduction (see Instructions)		29a 201,205,608		29b 27,192,837	
b Special deductions (Schedule C, line 20)				29c 228,398,445	
30 Taxable income - Line 28 less line 29c				30 31,344,191	
31 Total tax (Schedule J, line 10)				31 48,400,348	
32 Payments: a 1989 overpayment credited to 1990		32a		32b 67,064,688	
b 1990 estimated tax payments		32b		32c 67,064,688	
c Less 1990 refund applied for on Form 4466		32c		32d 3,000,000	
d Tax deposited with Form 7004				32e 70,064,688	
f Credit from regulated investment companies (attach Form 2439)		32f		32g	
g Credit for Federal tax on fuels (attach Form 4136). See Instructions		32g		32h	
33 Enter any penalty for underpayment of estimated tax - Check <input type="checkbox"/> if Form 2220 is attached				33	
34 Tax due - If the total of lines 31 and 33 is larger than line 32h, enter amount owed				34 23,664,340	
35 Overpayment - If line 32h is larger than the total of lines 31 and 33, enter amount overpaid				35 10,000,000	
36 Enter amount of line 35 you want: Credited to 1991 estimated tax <input type="checkbox"/> Refunded <input type="checkbox"/>				36 13,664,340	
Please Sign Here: Signature of officer G.H. DOLAN		Date 09/13/91		Title ASST. COMPTROLLER	
Paid: Preparer's signature JOHN F. DUFF		Date 09/13/91		Check if self-employed <input type="checkbox"/>	
Preparer's Use Only: Firm's name for yours if self-employed and address KPMG PEAT MARWICK				Preparer's social security no. 121-36-4177	
				E.I. No. 13-5585207	
				ZIP code 02108	

0C1110-1 1.000

H763

Form 870-AD
(rev. 04/92)

Department of the Treasury-Internal Revenue Service

Offer to Waive Restrictions on Assessment and Collection
of Tax Deficiency and to Accept OverassessmentSymbols:
AP:NE:RWDName of Taxpayer:
Liberty Mutual Insurance Company and Affiliated SubsidiariesSSN or EIN :
04-1543470

Under the provisions of section 6213(d) of the Internal Revenue code of 1986 (the Code), or corresponding provisions of prior internal revenue laws, the undersigned offers to waive the restrictions provided in section 6213(a) of the Code or corresponding provisions of prior internal revenue laws, and to consent to the assessment and collection of the following deficiencies and additions to tax, if any, with interest as provided by law. The undersigned offers also to accept the following overassessments, if any, as correct. Any waiver or acceptance of an overassessment is subject to any terms and conditions stated below and on the reverse side of this form.

Deficiencies (Overassessments)
and Additions to Tax

Year Ended	Kind of Tax	Tax				
December 31, 1985	Income	\$(202,435)				
December 31, 1986	Income	\$(1,225,322)				
December 31, 1987	Income	\$(1,035,285)				
December 31, 1988	Income	\$ 0				
December 31, 1989	Income	\$(2,617,590)				
December 31, 1990	Income	\$40,415,252				

This offer must be accepted for the Commissioner of Internal Revenue and will take effect on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted, the case will not be reopened by the Commissioner unless there was:

- fraud, malfeasance, concealment or misrepresentation of a material fact
- an important mistake in mathematical calculation
- a deficiency or overassessment resulting from adjustments made under Subchapters C and D of Chapter 63 concerning the tax treatment of partnership and subchapter S items determined at the partnership and corporate level
- an excessive tentative allowance of a carryback provided by law

No claim for refund or credit will be filed or prosecuted by the taxpayer for the years stated on this form, other than for amounts attributed to carrybacks provided by law.

The proper filing of this offer, when accepted, will expedite assessment and billing (or overassessment, credit or refund) by adjusting the tax liability. This offer, when executed and timely submitted, will be considered a claim for refund for the above overassessment(s), if any.

Subject to ADDITIONAL PROVISIONS on the reverse side of this form.

Signature of Taxpayer:

Date:

Signature of Taxpayer:

Date:

Signature of Taxpayer's Representative:

Date:

Corporate Name: Liberty Mutual Insurance Company and Affiliated Subsidiaries

Date:

By Corporate Officer:

Title

Date:

For

Date Accepted for Commissioner:

Signature:

Internal
Revenue
Use Only

Office:

Title:

Boston, MA

Appeals Team Case Leader

(See reverse side for signature instructions)

LIB - 000317

Department of the Treasury-Internal Revenue Service

Form 876-AD
(rev. 04/92)Offer to Waive Restrictions on Assessment and Collection
of Tax Deficiency and to Accept Overassessmentmbols:
NE:RWDName of Taxpayer:
Liberty Mutual Fire Insurance CompanySSN or EIN :
04-1924000

Under the provisions of section 6213(d) of the Internal Revenue code of 1986 (the Code), or corresponding provisions of prior internal revenue laws, the undersigned offers to waive the restrictions provided in section 6213(a) of the Code or corresponding provisions of prior internal revenue laws, and to consent to the assessment and collection of the following deficiencies and additions to tax, if any, with interest as provided by law. The undersigned offers also to accept the following overassessments, if any, as correct. Any waiver or acceptance of an overassessment is subject to any terms and conditions stated below and on the reverse side of this form.

Deficiencies (Overassessments)
and Additions to Tax

Year Ended	Kind of Tax	Tax				
December 31, 1987	Income	\$(116,569)				
December 31, 1988	Income	\$-0-				
December 31, 1989	Income	\$(341,363)				
December 31, 1990	Income	\$3,030,440				

This offer must be accepted for the Commissioner of Internal Revenue and will take effect on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted, the case will not be reopened by the Commissioner unless there was:

- fraud, malfeasance, concealment or misrepresentation of a material fact
- an important mistake in mathematical calculation
- a deficiency or overassessment resulting from adjustments made under Subchapters C and D of Chapter 63 concerning the tax treatment of partnership and subchapter S items determined at the partnership and corporate level
- an excessive tentative allowance of a carryback provided by law

No claim for refund or credit will be filed or prosecuted by the taxpayer for the years stated on this form, other than for amounts attributed to carrybacks provided by law.

The proper filing of this offer, when accepted, will expedite assessment and billing (or overassessment, credit or refund) by adjusting the tax liability. This offer, when executed and timely submitted, will be considered a claim for refund for the above overassessment(s), if any.

Subject to ADDITIONAL PROVISIONS on the reverse side of this form.

Signature of Taxpayer:		Date:
Signature of Taxpayer:		Date:
Signature of Taxpayer's Representative:		Date:
Corporate Name: Liberty Mutual Fire Insurance Company		Date:
Corporate Officer:	Title:	Date:
For Internal Revenue Use Only	Date Accepted for Commissioner:	Signature:
	Office:	Title:

(See reverse side for signature instructions)

1990 TR

Liberty Mutual Fire Insurance Company (04-1924000)

SECTION 6662 DISCLOSURE

The Revenue Reconciliation Act of 1990 ("the Act") provides that property and casualty insurance companies are required to reduce their losses incurred by discounted estimated salvage recoverable beginning in 1990. Section 11305(c)(3) of the Act allows companies that previously anticipated salvage recoverable to deduct 87 percent of the discounted amount of salvage recoverable previously taken into account prior to 1990. This deduction is to be taken into account over four taxable years beginning in 1990.

The Internal Revenue Service recently issued Revenue Procedure 91-48, the purpose of which was to provide guidance with respect to the discounting of estimated salvage recoverable, the Section 481 adjustment under Section 11305(c)(2) of the Act, the special deduction under Section 11305(c)(3) of the Act, the special rule for over estimates under Section 11305(c)(4) of the Act and changes in estimates of salvage recoverable.

The taxpayer is not following the provisions of Revenue Procedure 91-48 in this tax return with respect to the mutually exclusive rule contained in Sections 8 and 9 of the Revenue Procedure. The taxpayer feels that Revenue Procedure 91-48 provides for an improper interpretation of the tax law with respect to this item. Further clarification resulting from industry discussions with the Internal Revenue Service on these items may result in the taxpayer filing an amended tax return.

Also, the taxpayer understands that if an election is not made under Section 11 of the Revenue Procedure with respect to the "deferral of an accounting change", then the taxpayer who claims the special deduction will be forever precluded from making an election to defer the accounting change. The taxpayer intends to make a protective election under Section 11 of the Revenue Procedure, pending clarification of Sections 8 and 9 of the Revenue Procedure.

While the next-to-last sentence of Revenue Procedure 91-48, Section 4.02, seems to suggest that an insurer claiming the 87 percent transitional deduction under Section 11305(c)(3) of the Act has to ignore the discounted year-end 1989 salvage and subrogation recoverable in the computation of "losses incurred" for 1990 under Code Section 832(b)(5)(A), the taxpayer finds nothing in the wording of Code Section 832 or 1990 Act Section 11305 that would require such a result. The taxpayer believes that the 87 percent transitional deduction was

Section 6662 Disclosure Continued 04-1924000

intended to provide a "level playing field" between insurers that were anticipating (and thus paying taxes on) salvage and subrogation before 1990 and those that were not. Accordingly, it is taxpayer's position that the benefit of the 87 percent transitional deduction is available in addition to the benefit of including prior-year-end salvage and subrogation in the computation under Code Section 832(b)(5)(A).

While the amount of salvage and subrogation recoverable was not shown explicitly on the taxpayer's 1989 annual statement, the methods used by the taxpayer in computing its reserves for unpaid losses on its 1989 annual statement had the effect of implicitly anticipating salvage and subrogation recoverable. The taxpayer is prepared to establish to the satisfaction of the IRS District Director that this result did occur in the preparation of its 1989 annual statement, and to show the specific amounts of anticipated salvage and subrogation by line of insurance for each accident year.

The taxpayer has not filed a statement with a state regulatory authority as described in proposed regulation Section 1.832-4(e). As the taxpayer reads that portion of the proposed regulation, filing such a statement with a state regulatory authority is intended to be one method, but not necessarily the only method, by which an insurer may establish that it took estimated salvage and subrogation recoverable into account. Furthermore, taxpayer finds nothing in Section 11305(c)(3) of the Act to indicate that submitting such a statement to a state regulatory authority is a necessary condition for claiming the 87 percent transitional deduction.

At this time, the taxpayer has not quantified the tax effects of these issues.

Liberty Mutual Fire Insurance Company (04-1924000)

**ELECTION FOR TAXPAYERS CLAIMING SPECIAL DEDUCTION THAT ALSO
TOOK SALVAGE INTO ACCOUNT IN DETERMINING UNDISCOUNTED
UNPAID LOSSES FOR THE 1990 ACCIDENT YEAR PURSUANT TO
SECTION 11 OF REV. PROC. 91-48**

The taxpayer feels that Revenue Procedure 91-48 contains conditions which have no basis in law and that improper interpretations of the law have been made, however, we feel it necessary, in the event that Rev. Proc. 91-48 is found to be correct, to make a protective election under Section 11. The taxpayer therefore makes an election under Sections 11 of Revenue Procedure 91-48, and agrees to apply the special rule for overestimates in section 11305(c)(4) of the 1990 Act.

The taxpayer is unable to determine the amount of estimated salvage recoverable taken into account in determining the undiscounted unpaid losses for the 1990 accident year due to the mutually exclusive rules contained in Sections 8 and 9 of Revenue Procedure 91-48. Further clarification resulting from industry discussions with the Internal Revenue Service on these items may result in the taxpayer filing an amended tax return

Affirmative Adjustment under Rev-Proc. 92-77

(1) Rev. Proc. 92-77 allows taxpayers a choice between effectively taking the special deduction for salvage and subrogation in one year or spreading it over four years. However, it was not possible for taxpayers to be aware of this option when their 1990 and 1991 tax returns were filed.

(2) By eliminating the special deduction that was taken in 1990 and 1991, Liberty Mutual Insurance Group will be in compliance with the mutually exclusive rule. The mutually exclusive rule says that taxpayers claiming the fresh start cannot also claim the special deduction. We hereby elect to eliminate the special deduction. The worksheets attached summarize the affect of eliminating the special deduction.

In order to implement the one year deduction option allowed under Rev-Proc 92-77, we request an affirmative issue on audit.

AFFIRMATIVE ADJUSTMENT

As Filed	1990	1991	1992	1993	Total
Gross Reserves	(\$68,763,075)				
Less: 481 Inclusion	\$2,234,800	\$2,234,800	\$2,234,800	\$2,234,800	
Decrease in Income	(\$66,528,275)				
Deduction for Net Reserves	(\$41,583,257)	(\$41,583,257)	(\$41,583,257)	(\$41,583,257)	
As adjusted	(\$108,111,532)	(\$39,348,457)	(\$39,348,457)	(\$39,348,457)	(\$226,156,903)
Gross reserves	(\$269,232,261)				
Less: 481 Inclusion	\$8,750,048	\$8,750,048	\$8,750,048	\$8,750,048	
Decrease in Income	(\$260,482,213)				
Deduction for Net Reserves	\$0				
Change	(\$260,482,213)	\$8,750,048	\$8,750,048	\$8,750,048	(\$234,232,069)
Consolidated change	(\$152,370,681)	\$48,098,505	\$48,098,505	\$48,098,505	(\$8,075,166)
	(\$137,133,613)				
File Company change	(\$15,237,068)				
	(\$152,370,681)				

Reconciliation of Original to Adjusted

	@12/31/89 Undiscounted	Discounted	Gross Reserves	Net Reserves	Reserve Forgiveness	Annual 481 Inclusion	Annual 481 Deduction	Net Annual (Increase) or Decrease
Original Estimate of S & S	\$309,668,095	\$255,981,560	\$68,763,075	\$187,218,485	\$59,823,875	\$2,234,800	\$40,720,020	\$38,485,221
Adjustments								
Auto Phys Damage	\$84,340							
Auto Liability	\$43,136							
Recast Dir Voluntary @ 12/89	\$247,123,000							
Mass Car	\$26,574,749							
NCCI Pool	\$49,860,245							
W/C Liberty N/Wes	\$5,252,079							
	\$328,937,549	\$269,232,261	\$269,232,261	\$0	\$234,232,067	\$8,750,048	\$0	(\$8,750,048)

Salvage and Subrogation Recoverable on Paid and Unpaid
Losses at December 31, 1989

Line of Insurance	Recoverable \$ & Actuarial Estimats @ 12/31/89	Discounted Reserves Recognized on Not Recognized Books of Compa @ 12/31/89	A/S Reserves Grossed-Up Reserve Forgiveness 87%	Annual 481 Adjustment over 4 years 13%	A/S Reserves Netted Reserve Forgiveness 87%	Annual Addition Deduction over Years	Net Annual (Increase) or Decrease in Taxable Income
Auto Phy Dama	91,025,877	86,468,745	0	75,228,678	2,810,267	0	(2,810,267)
Auto Liability	23,178,348	20,356,071	0	17,709,782	661,572	0	(661,572)
General Liability	5,811,000	4,397,466	0	3,825,795	142,918	0	(142,918)
Workers Comp	189,408,324	140,860,623	0	122,548,742	4,577,970	0	(4,577,970)
Fidelity & Burg	620,000	592,715	0	515,662	19,263	0	(19,263)
Comm Multl Perl	15,783,000	13,617,960	0	11,847,626	442,584	0	(442,584)
Fire & Allied	3,111,000	2,937,680	0	2,555,782	85,475	0	(85,475)
Total	328,937,549	269,232,261	0	234,232,067	8,750,048	0	(8,750,048)
Adjustment to 1990 Income							(8,750,048)
Adjustment to 1991 Income							(8,750,048)
Adjustment to 1992 Income							(8,750,048)
Adjustment to 1993 Income							(8,750,048)
Total							(35,000,194)
Net Effect		\$234,232,067					

09/13/83

Federal Income Taxes 1990 OBRA
 Salvage and Subrogation Recoverable on Paid and Unpaid
 Losses at December 31, 1989

Line of Insurance	Actuarial Estimate of Recoverable	Undiscounted Reserves	Discount Factor	Actuarial Estimate of Recoverable	Discounted Reserves
Auto Physical Dam	@ 12/31/89	Books of Comps	@ 12/31/89	Books of Comps	Books of Comps
AY+0	59,222,396	47,118,517	12,103,879	95,463.1%	56,535,535
AY+1	20,993,337	16,702,717	4,290,620	92,855.2%	19,493,405
AY+2	7,113,825	5,659,901	1,453,924	96,583.4%	6,870,774
AY+3	2,296,280	1,826,968	469,314	96,583.4%	2,217,825
AY+4	753,021		753,021	96,583.4%	727,293
AY+5	285,007		285,007	96,583.4%	275,269
AY+6	116,008		116,008	96,583.4%	112,044
AY+7	51,003		51,003	96,583.4%	49,260
AY+8	195,000		195,000	96,583.4%	188,338
AY+9			0		0
AY+10			0		0
AY+11			0		0
AY+12			0		0
AY+13			0		0
AY+14			0		0
AY+15			0		0
Total	91,025,877	72,422,000	19,717,776	86,469,745	67,721,209
					18,748,536

Line of Insurance	Actuarial Estimate of Recoverable	Undiscounted Reserves	Discount Factor	Actuarial Estimate of Recoverable	Discounted Reserves
Auto Liability	@ 12/31/89	Books of Comps	@ 12/31/89	Books of Comps	Books of Comps
AY+0	8,865,207	8,865,207	87,962.1%	7,798,022	7,798,022
AY+1	7,868,418	7,868,418	87,789.5%	6,907,645	6,907,645
AY+2	3,206,475	3,206,475	88,381.2%	2,833,921	2,833,921
AY+3	1,406,222	1,406,222	87,660.0%	1,232,694	1,232,694
AY+4	788,400	788,400	86,607.5%	682,814	682,814
AY+5	216,902	216,902	84,368.9%	182,998	182,998
AY+6	372,567	372,567	83,078.9%	309,525	309,525
AY+7	121,716	121,716	83,189.0%	101,254	101,254
AY+8	63,158	63,158	86,655.1%	54,730	54,730
AY+9	269,283	269,283	93,756.1%	252,469	252,469
AY+10	0	0	93,756.1%	0	0
AY+11	0	0	93,756.1%	0	0
AY+12	0	0	93,756.1%	0	0
AY+13	0	0	93,756.1%	0	0
AY+14	0	0	93,756.1%	0	0
AY+15	0	0	93,756.1%	0	0
Total	23,178,348	23,178,348		20,356,071	20,356,071

Line of Insurance	Undiscounted Reserves		Discounted Reserves	
	Actuarial Estimat of Recoverable	Books of Compa @ 12/31/89	Actuarial Estimat of Recoverable	Books of Compa @ 12/31/89
General Liability				
AY + 0	1,109,000		74,5408%	826,657
AY + 1	850,000		76,4051%	649,443
AY + 2	562,000		78,3308%	440,219
AY + 3	1,366,000		77,3635%	1,056,785
AY + 4	888,000		76,2351%	676,968
AY + 5	52,000		73,9097%	38,433
AY + 6	112,000		72,9563%	81,711
AY + 7	0		71,2185%	0
AY + 8	872,000		71,9322%	627,249
AY + 9	0		74,9278%	0
AY + 10	0		85,7395%	0
AY + 11	0		85,7395%	0
AY + 12	0		85,7395%	0
AY + 13	0		85,7395%	0
AY + 14	0		85,7395%	0
AY + 15	0		85,7395%	0
Total	5,811,000	0	4,397,466	4,397,466

Line of Insurance	Undiscounted Reserves		Discounted Reserves	
	Actuarial Estimat of Recoverable	Books of Compa @ 12/31/89	Actuarial Estimat of Recoverable	Books of Compa @ 12/31/89
Workers Comp				
AY + 0	51,982,726		79,2331%	41,187,525
AY + 1	49,548,999		75,0361%	37,179,636
AY + 2	42,931,413		72,8193%	31,262,354
AY + 3	22,284,827		69,9799%	15,594,909
AY + 4	10,412,422		68,6137%	7,144,348
AY + 5	4,148,682		67,1574%	2,786,147
AY + 6	2,548,233		67,9048%	1,730,373
AY + 7	1,237,922		68,6515%	849,852
AY + 8	627,852		69,6203%	437,112
AY + 9	3,685,248		72,9494%	2,688,366
AY + 10	0		85,2792%	0
AY + 11	0		85,2792%	0
AY + 12	0		85,2792%	0
AY + 13	0		85,2792%	0
AY + 14	0		85,2792%	0
AY + 15	0		85,2792%	0
Total	189,408,324	0	140,860,623	140,860,623

		Undiscounted Reserves		Discounted Reserves	
Line of Insurance	Actuarial Estimate of Recoverable	Recognized on Books of Compa	Not Recognized Discount Factor @ 12/31/89	Actuarial Estimate of Recoverable	Recognized on Books of Compa
Fidelity & Burglary	@ 12/31/89	@ 12/31/89	@ 12/31/89	@ 12/31/89	@ 12/31/89
AY + 0	69,000	69,000	93.9533%	64,828	0
AY + 1	115,000	115,000	92.8552%	106,783	0
AY + 2	85,000	85,000	96.5834%	82,096	0
AY + 3	48,000	48,000	96.5834%	46,360	0
AY + 4	190,000	190,000	96.5834%	183,508	0
AY + 5	39,000	39,000	96.5834%	37,668	0
AY + 6	3,000	3,000	96.5834%	2,898	0
AY + 7	9,000	9,000	96.5834%	8,693	0
AY + 8	62,000	62,000	96.5834%	59,882	0
AY + 9		0		0	0
AY + 10		0		0	0
AY + 11		0		0	0
AY + 12		0		0	0
AY + 13		0		0	0
AY + 14		0		0	0
AY + 15		0		0	0
Total	620,000	0	620,000	592,715	0
				592,715	592,715

Line of Insurance		Actuarial Estima. Recognized on Not Recognized		Discounted Reserves		
Comm Multi Peril		Books of Compa		Books of Compa		
		@ 12/31/89 @ 12/31/89		@ 12/31/89 @ 12/31/89		
AY + 0	6,007,000	6,007,000	87.6120%	5,262,853	0	5,262,853
AY + 1	4,400,000	4,400,000	85.0222%	3,740,977	0	3,740,977
AY + 2	2,484,000	2,484,000	85.9497%	2,117,801	0	2,117,801
AY + 3	1,478,000	1,478,000	85.9857%	1,270,869	0	1,270,869
AY + 4	627,000	627,000	86.1380%	540,085	0	540,085
AY + 5	434,000	434,000	84.1235%	365,096	0	365,096
AY + 6	180,000	180,000	83.9594%	151,127	0	151,127
AY + 7	54,000	54,000	87.2273%	47,103	0	47,103
AY + 8	139,000	139,000	87.8062%	122,051	0	122,051
AY + 9		0	80.7397%	0	0	0
AY + 10		0	92.6060%	0	0	0
AY + 11		0	92.6060%	0	0	0
AY + 12		0	92.6060%	0	0	0
AY + 13		0	92.6060%	0	0	0
AY + 14		0	92.6060%	0	0	0
AY + 15		0	92.6060%	0	0	0
Total	15,783,000	0	15,783,000	13,617,960	0	13,617,960

Line of Insurance Fire & Allied	Undiscounted Reserves		Discounted Reserves	
	Actuarial Estimats of Recoverable @ 12/31/89	Recognized on Books of Compa @ 12/31/89	Discount Factor @ 12/31/89	Actuarial Estimats of Recoverable Books of Compa @ 12/31/89
AY+0	938,000	938,000	93.2650%	874,826
AY+1	963,000	963,000	92.8552%	894,196
AY+2	686,000	686,000	96.5834%	662,562
AY+3	239,000	239,000	96.5834%	230,834
AY+4	70,000	70,000	96.5834%	67,608
AY+5	70,000	70,000	96.5834%	67,608
AY+6	99,000	99,000	96.5834%	95,618
AY+7	10,000	10,000	96.5834%	9,658
AY+8	36,000	36,000	96.5834%	34,770
AY+9		0		0
AY+10		0		0
AY+11		0		0
AY+12		0		0
AY+13		0		0
AY+14		0		0
AY+15		0		0
Total	3,111,000	0 3,111,000		2,937,680 0 2937680.416

Workers Comp

Accident Year	Direct	Ceded	Assumed NCCI Pool	Northwest Amts	Net Recoverable
1989	36,210,000	0	13,743,925	2,028,801	51,982,726
1988	34,120,000	0	13,828,895	1,600,104	49,548,999
1987	30,825,000	0	11,162,303	944,110	42,931,413
1986	16,583,000	0	5,160,557	541,270	22,284,827
1985	8,444,000	0	1,833,579	134,843	10,412,422
1984	3,340,000	0	805,808	2,874	4,148,682
1983	1,965,000	0	583,156	77	2,548,233
1982	775,000	0	462,922		1,237,922
1981	0	0	627,852		627,852
Prior	2,034,000	0	1,651,248		3,685,248
Total	134,296,000	0	49,860,245	5,252,079	189,408,324

Auto Physical Damage

Accident Year	Direct	Ceded	Assumed MassCAR	Assumed Other	Net Recoverable
1989	51,026,000	0	8,141,281	55,115	59,222,396
1988	11,285,000	0	9,690,185	18,152	20,993,337
1987	4,099,000	0	3,003,827	10,998	7,113,825
1986	1,494,000	0	802,244	36	2,296,280
1985	753,000			21	753,021
1984	285,000			7	285,007
1983	116,000			8	116,008
1982	51,000			3	51,003
1981				0	0
Prior	195,000				195,000
Total	69,304,000	0	21,637,537	84,340	91,025,877

Auto Liability

Accident Year	Direct	Ceded	Assumed MassCAR	Assumed Other	Net Recoverable
1989	7,737,000	0	1,097,051	31,156	8,865,207
1988	5,532,000	0	2,329,794	6,624	7,868,418
1987	2,332,000	0	871,842	2,633	3,206,475
1986	1,200,000	0	204,427	1,795	1,406,222
1985	721,000	0	66,837	563	788,400
1984	166,000	0	50,538	364	216,902
1983	239,000		133,566	1	372,567
1982	22,000		99,716	0	121,716
1981	0		63,158	0	63,158
Prior	249,000		20,283	0	269,283
Total	18,198,000	0	4,937,212	43,136	23,178,348

Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit
Name of Taxpayer Liberty Mutual Insurance Pool		Year/Period Ended 1988 - 1990

which estimated salvage recoverable was not separately taken into account is a change in method of accounting for which taxpayer must receive approval by the Commissioner.

Government's Position:

The government contends, pursuant to Treas. Reg. 1.832-4(f)(3)(iii), that any taxpayer that "claims the special deduction is precluded from also claiming the section 481 adjustment..." The government also maintains that once a company has taken the special deduction any change in method of computing unpaid losses can only be done so with the consent of the Commissioner. This position is based on section 4.04 of Rev. Proc. 92-77.

Conclusion:

Accordingly, the government is denying the taxpayer request for affirmative adjustment to change from claiming the Special Deduction and the Fresh Start to claiming only the Fresh Start.